TREASURY DEPARTMENT
UNITED STATES INTERNAL REVENUE

EXCESS PROFITS TAX PRIMER

PREPARED BY THE BUREAU OF
INTERNAL REVENUE FOR THE INFORMATION
AND ASSISTANCE OF TAXPAYERS

WASHINGTON
GOVERNMENT PRINTING OFFICE
1918

To the Taxpayer:

The great body of patriotic taxpayers are anxious to pay their taxes and thus fulfill their whole financial duty to the Government. This department is equally anxious to help them fulfill that duty without prejudicing their own interests or paying a larger tax than under the law they are called upon to pay. To attain this end, cooperation along the following lines is necessary:

1. File your return promptly. You have until April 1 to do this, but you will greatly assist the Government by filing your return now. This will be to your own advantage, for, if you have any problem that requires special attention, the sooner your return is in the earlier will your case be reached and decided.

2. Secure from your collector the proper return form and read carefully the instructions and questions printed thereon. Get at the same time a copy of Regulations No. 41 and use the index. When in doubt on any point, consult your collector or revenue agent, or your banker. If still in doubt, answer each question as you understand it and send with your return a statement of the questions about which you are uncertain. A decision can then be made at Washington, where the administrative authorities are as anxious to protect your interests as to obtain the revenue. In this way you will be protected against penalties.

3. If you can not determine your invested capital, or if for any other reason you believe yourself entitled to make claim for assessment under section 210 (art. 52 of the regulations), make out your return as best you can from the information at hand and file with it a full explanation of the facts, showing wherein information for making out a complete return is lacking, or why you think you are entitled to assessment under section 210.

4. If you are able to compute the amount of your excess-profits tax, you may pay the tax at the time you file your return. By so doing you will reduce the great rush in the payment of taxes in June. If you pay the tax in advance, you may deduct from the amount of the tax due a sum equal to 3 per cent per annum calculated from the date of payment to June 15, 1918. Taxes may also be paid in installments, provided the installments do not extend beyond June 15. Your collector will explain how this may be done.

DANIEL C. ROPER, *Commissioner.*

EXCESS PROFITS TAX PRIMER.

GENERAL FEATURES.

TAX APPLIES TO TRADE OR BUSINESS.

In the case of a corporation or partnership the law expressly provides (sec. 201) that all its income, from whatever source derived, shall be deemed to be received from its trade or business. In this case there is one business and one net income.

In the case of an individual the excess-profits tax applies only to that part of the net income which is derived from the taxpayer's trade, business, profession, or occupation, even though the taxpayer may have other income subject to the ordinary income tax. Unlike a corporation or partnership, an individual may be engaged in two businesses, one with invested capital, one with no invested capital or only a nominal capital. If he has more than one business with invested capital, they will all be regarded as one; and if he has more than one business with no invested capital, they will be regarded as one. If he has both kinds of business, he will be regarded as having two businesses.

IT IS AN INCOME TAX.

It is an income tax in addition to the regular income tax of September 8, 1916, as amended, and the war income tax of October 3, 1917. It is more than a tax on "war profits": it reaches all income in excess of a stipulated normal deduction. The tax falls into two classes:

(*a*) An 8 per cent tax imposed by section 209 upon trades or businesses having no invested capital or merely a nominal capital, e. g., doctors, lawyers, and professional or salaried persons in general. Domestic corporations under this section are allowed a specific deduction of $3,000; domestic partnerships and individual citizens or residents a specific deduction of $6,000. (See articles 71–74 of Regulations, No. 41.)

(*b*) A graduated tax with rates rising from 20 to 60 per cent upon the net income in excess of a deduction equal to a percentage (varying from 7 to 9 per cent) upon invested capital, *plus* $6,000 in the case of an individual or partnership or $3,000 in the case of a corporation. Foreign corporations or partnerships and nonresident aliens are not entitled to the specific deductions of $3,000 or $6,000, respectively.

An exceedingly important subdivision under class (*b*) consists of those cases in which the invested capital—or the net income for the prewar period—can not be satisfactorily determined. In such cases the assessment is based largely upon conditions or relations existing among representative business concerns in a like or similar trade or business. (See Sections 205 and 210 of the law and Articles 18, 21, and 52 of Regulations No. 41.)

CLASSIFICATION OF TAXPAYERS.

In the case of a corporation or partnership all of its income will be held to be of the same class as the income from its principal trade or business. There is one income and one tax. (Article 14 of Regulations No. 41.)

In the case of an individual there may be income subject to the 8 per cent rate and income subject to the graduated rates, in which case there will be two deductions and two taxes—but not more than two. (See Articles 35 and 36 of Regulations No. 41.)

In general, the taxpayer can not decide for himself whether he is subject to the 8 per cent tax or the graduated tax but must fill out the ordinary form so far as possible in order that the department may decide into which class he properly falls. Exception, however, is made in the case of individuals whose income consists wholly of salary or the earnings of personal service and who employ no invested capital in their trade or business. In such cases the excess profits tax will be computed from the data on the income tax return Form 1040.

INCOME SUBJECT TO TAX—CORPORATIONS, PARTNERSHIPS, AND INDIVIDUALS.

1. A partnership makes $80,000, one-fourth of which is paid to a special or silent partner who takes no real part in the conduct of the business. Is the partnership taxable with respect to the $20,000 paid to the silent partner?

Yes. The partnership is engaged in business and is taxable upon its entire net income. However, no member of the partnership as an individual is subject to excess-profits tax on his share of the partnership profits. (See Article 41 of Regulations No. 41.)

2. A corporation has been making income-tax returns on the basis of a fiscal year ending June 30. Net income for the last six months of 1916 was $1,000,000. The losses for the first six months of 1917 were $400,000. Is there any taxable income subject to excess-profits tax for the year 1917?

Yes. The profits for the full fiscal year were $600,000. One-half of the fiscal year falling in the calendar year 1917, the corporation will be taxable on a proportionate amount. The corporation should make a return for the full fiscal year, compute the tax that would ordinarily be due for an entire year, and then take a proportionate part (in this case one-half) as the tax to be paid. (See Article 19 of Regulations No. 41.)

3. Is a "Massachusetts trust" taxed as a corporation or partnership?

As a corporation. The term "corporation" includes joint-stock companies or associations, no matter how created or organized. (See Article 2 of Regulations No. 41.)

4. A. B., an attorney, bought a house and lot in June, 1917, received rent from it until October, 1917, and then sold it at a profit. Does he pay on rentals and the profit?

An attorney whose business is of a purely personal-service nature is taxable at 8 per cent under section 209. He might buy real

estate for investment and later sell it at a considerable profit, but this being an isolated transaction and not a business, the income and profits therefrom would not be subject to excess-profits tax. He would be entitled to one deduction of $6,000.

5. A lawyer with a considerable income from his practice, receives fees as director in two banks and an insurance company. Are such fees taxable?

Regular service as a director constitutes an occupation or business and the fees therefrom, along with the regular income of the lawyer from his practice, are taxable at 8 per cent under section 209, with one deduction of $6,000.

6. A landlord renting a large farm on shares, which requires considerable attention, employs an agent to look after his interest, see that the farm buildings are kept in good repair, collect and market his share of the crops, etc. Is the rental taxable?

Yes; at the graduated rates. The landlord is engaged in business with respect to the farm and the fact that he employs an agent to look after his business does not relieve him from the tax nor entitle him to the 8 per cent rate.

7. John Smith owns and operates a dry goods store. He also owns and operates a shoe store. Is he allowed to report these businesses separately with a separate deduction for each?

No; the rule is that there may be one deduction for a business with no invested capital or merely a nominal capital (personal service), and another deduction for an unrelated business having invested capital, but there may not be more than one deduction for businesses taxed under section 201, or for businesses taxed under section 209.

8. I conduct two entirely separate businesses both employing invested capital. Should I make a combined return for the two businesses, or a separate return for each business?

You should make one return covering the two businesses.

9. A contractor and dealer in real estate also lists property owned by others and does business as a real estate agent or broker. How is he taxed?

These activities are so interrelated as to constitute one business. If the individual employs in this real estate business a considerable amount of capital he is taxable at the graduated rates under section 201.

10. I am a doctor and also manage and direct a small factory which I own. How am I taxed?

You will pay a tax of 8 per cent on the fees from your medical practice under section 209, and a graduated tax on the income from your factory. Under section 209 you will get a deduction of $6,000; under section 201 a specific deduction of $6,000 plus a percentage deduction of from 7 to 9 per cent on the capital invested in the factory.

11. A school teacher buys a farm upon which oil is discovered, and sells the farm at a large profit. Is such profit subject to excess-profits tax?

Not unless the teacher is also a farmer or buys and sells real estate with sufficient frequency to make the latter one of his occupations. The teacher may have an occupation or business other than teaching the profits from which would be taxable, but if he buys a farm simply as an isolated investment and does not run it, the profits from its sale would not be subject to the tax. (See question 12.)

12. A manufacturer who has been in business for many years sells his factory at a considerable profit. Is such profit subject to excess-profits tax?

Yes; because the profit in this and similar cases is a normal result of winding up the business; it is part of the business. On the other hand, if the manufacturer had bought a farm and sold it at a profit, the profit would not—if the transaction were isolated—be taxable. Profit from an isolated transaction outside of his business is not taxable. Profit from an isolated transaction connected with his business is taxable.

13. I am a traveling salesman, working wholly on a commission basis. I earn $15,000. My traveling expenses are $3,000. My house advances me $6,000 per year, giving me the rest of my commissions at the end of the year. May I consider that I am in business and allow myself a salary of $6,000, leaving a profit of $6,000 for the business itself? In that case I should be entitled to a deduction of $6,000 for the business and $6,000 against my salary and I should have no excess-profits tax to pay.

No. You should enter the $15,000 in block A on Form 1040, making proper deduction for expenses. You would then have a net income of $12,000, of which $6,000 would be taxable at the 8 per cent rate.

14. An individual who received a salary of $8,000 during the taxable year has a minor son who earned $800 during the taxable year in a separate occupation. Must the $800 be included in the income of the parent subject to excess-profits tax?

No. The father is not engaged in business with respect to the income of his minor children earned in a separate and distinct occupation.

DEDUCTIONS.

15. A corporation had a net income of $10,000 in 1911, $8,000 in 1912, and a loss of $2,000 in 1913. What is the "average amount of the annual net income of the trade or business during the prewar period," for the purpose of determining the percentage deduction?

Six thousand dollars ($18,000 divided by three). The loss of $2,000 is disregarded inasmuch as the income tax law does not permit the loss of one year to affect or reduce the profit of another year.

16. A firm commenced business April 1, 1911. What period should it use to determine its prewar earnings and invested capital?

All of the years 1912 and 1913. The year 1911 is disregarded, as the law provides that only entire calendar years shall be counted. (See sec. 200.)

17. What percentage deduction is given a taxpayer who started in business after January 1, 1913?

Eight per cent of the invested capital. (See sec. 204 of the law and art. 21 of Regulations No. 41.)

18. Jones was in the hardware business during the prewar period. He made more than 9 per cent on his invested capital. In 1914 he sold the hardware business and established a furniture store and is making over 9 per cent. What percentage deduction does he get?

Eight per cent, since he is now carrying on a business in which he was not engaged during the prewar period. However, if he had bought an *established* furniture business having prewar earnings of 9 per cent, he would be allowed 9 per cent, the business being a continuation of a business with prewar experience. (See section 204 of the law and article 22 of Regulations No. 41.)

19. Smith bought a hotel business in 1914 which had been in existence during the prewar period, but he is unable to ascertain what was its average invested capital for that period. What is his percentage deduction?

He should compute the tax in the first instance on the basis of a 7 per cent deduction, but may file a claim (with explanation) for final assessment under the provisions of section 210 (articles 24 and 52 of regulations. No. 41), and if the Secretary of the Treasury is unable satisfactorily to determine the invested capital, the percentage deduction will be computed at the same rate per cent as in the case of representative individuals engaged in a like or similar business.

20. An individual is engaged in the manufacturing business. He makes annual contributions to a near-by hospital in which injured employees of his establishment are cared for. He also makes contributions to his church and to the public library. Is he allowed to deduct these contributions in computing his net income for purposes of the excess-profits tax?

The contributions to the hospital would constitute a proper deduction, since they have a reasonable connection with his business, and may be considered as coming from the business rather than from the individual in his personal capacity. Such contributions will be allowed up to 15 per cent of the income of the business.

The contributions to the church and the library will be regarded as made by the individual in his personal capacity and are not allowable deductions from the income of the trade or business for the purposes of the excess-profits tax. (See article 37 of Regulations No. 41.)

21. A partnership has been in the habit of making contributions to various churches, local charities, and the Y. M. C. A., and charging the amounts off to profit and loss at the end of the year. Will it be allowed to deduct these contributions in computing its net income for purposes of the excess-profits tax?

No. These contributions are not connected with the trade or business. The same rule applies in the case of a partnership as in the case of an individual. (See section 206 of the law and article 37 of Regulations No. 41.)

22. An incorporated department store occasionally contributes to local charities, hospitals, etc. Are these items deductible?

No. Donations which do not have in them the element of compensation are considered gratuities and are not allowable deductions from gross income as an expense of operation or maintenance or under any other head. (See articles 134 and 135, Regulations No. 33 (Revised), governing the collection of the income tax.)

23. Several of our regular employees have enlisted in the service of the United States in different capacities, some in the Army, others in the Navy, Food Administration, etc. We have continued their salaries during their absence. May we charge these payments as expense in computing our profits?

Yes.

24. Four other attorneys and myself conduct a law business under a partnership arrangement. There is no invested capital. It is our custom to distribute the entire net income to the partners as salaries, leaving the partnership no net profits. May we continue to do this? If the partnership makes a return it will be entitled to a deduction of $6,000 and the several partners are each entitled to the same deduction. In other words, if we make a separate return for the partnership there will be a total of six $6,000 deductions, whereas if all the net income is distributed and taxed to the individual partners there will be only five such deductions. In the latter case the Government will collect $480 more tax. We prefer not to a make a partnership return.

The department will not recognize a division or sharing of the entire net income of a partnership as an allowable method of determining the salaries of the partners, although in rare cases the salaries may exhaust or even exceed the net income of the partnership. (See article 32 of Regulations No. 41.) Every domestic partnership having a net income of $6,000 or more *without deducting salaries or interest paid to partners* must make a return of income on Form 1065.

CONCERNS IN OPERATION ONLY PART OF TAXABLE YEAR.

25. A partnership was established and began operations August 1, 1917. The capital invested was $300,000 and the net income for the five remaining months of 1917 was $60,000. What is the tax?

As the net income covers only five-twelfths of a year, the deduction and the invested capital must be brought to the same basis. Five-twelfths of the total deduction for a full year is $12,500. (The percentage deduction for a full year would be $24,000 and the specific deduction would be $6,000, a total of $30,000. Five-twelfths of the last figure is $12,500.) Five-twelfths of the total invested capital is $125,000. Thus in this case the tax would be computed on the basis of an invested capital of $125,000, net income of $60,000, and a total deduction of $12,500. The tax would be $20,750.

26. A corporation organized July 1, 1917, makes $2,400 in the last half of that year. Is it required to make return and pay excess-profits tax?

Yes. A corporation engaged in business for only a part of the year must make return if its net income is *at the rate of $3,000 or more per annum.* A similar rule applies to an individual or partnership engaged in business for only part of the taxable year: a return must be made and the excess-profits tax paid if the net income for the taxable year is *at the rate of $6,000 or more.* (This answer does not apply in the case of a corporation or partnership whose first fiscal year ends in 1918 and which has secured permission to make its return on the basis of its fiscal year.)

INVESTED CAPITAL.

27. Secton 207 (clause 3) authorizes the inclusion in invested capital of "paid in or earned surplus and undivided profits used or employed in the business." Can a corporation or partnership have any surplus or undivided profits which for purposes of the excess-profits tax will not be deemed to be used or employed in the business?

All the surplus and undivided profits of a corporation or partnership (exclusive of undivided profits earned during the year) will, unless invested in assets the income from which is not subject to the excess-profits tax, be deemed to be used or employed in the business and may be included in the invested capital. (See art. 62 of Regulations No. 41.)

28. A corporation balances its books monthly, carrying profits into surplus account. Is the capital as of January 1st increased for the purposes of the excess-profits tax by the addition of these monthly profits?

No. The law specifically excludes undivided profits earned during the taxable year. The profits accumulated during the year, even though entered on the books as surplus before the close of the year, can not be counted as additions to the capital for that year. (See art. 61 of Regulations No. 41.)

29. In computing invested capital for the purposes of the excess-profits tax, may a corporation take as the value of its capital stock the amount fixed by the department for the purposes of the capital-stock tax?

No. Each return must be prepared in accordance with the provisions of the law under which it is made.

30. According to section 207, bonds (other than obligations of the United States), the income from which is not

subject to the excess-profits tax, can not be included in invested capital. Section 200 states that "The term 'United States' means only the States, the Territories of Alaska and Hawaii and the District of Columbia." May State bonds be included in invested capital?

No. The above definition applies only in a geographical sense. The term "United States" in the parenthetical clause above is not used in a geographical sense. Hence the term "obligations of the United States" means only obligations of the Federal Government.

31. In 1901 a corporation was organized and took over the assets of a dozen going concerns, issuing therefor $25,000,000 of capital stock. The assets consisted of various plant structures, equipment, real estate, patents, and good will. At the time of the transaction all of these items were entered in a lump sum and no attempt was made to indicate the specific amounts of stock issued for the respective kinds of property. It is shown that at that time the tangible property was worth $10,000,000, the patents $2,000,000, and the good will not less than $7,000,000. How is the invested capital to be computed?

In accordance with article 59 of Regulations No. 41, it will be presumed that $12,000,000 of the stock was issued for the tangible property and the patents and that $13,000,000 was issued for good will. The tangible property will be taken at its value as of January 1, 1914, but not to exceed $10,000,000, the par value of the stock deemed to have been issued for it. The patents will be taken at their value at the time of acquisition, namely, $2,000,000. Although $13,000,000 of stock was issued for the good will, it can be taken at only $5,000,000, i. e., 20 per cent of the total stock outstanding on March 3, 1917.

32. A banking corporation began operations in 1902. In the course of 12 years, for reasons of conservatism, the bank charged off practically the entire value of its building, and since January 1, 1915, has been carrying it on its books at the nominal figure of $1. Can any of this value be restored for the purpose of computing invested capital?

Yes. The building may be taken at cost, less a fair allowance for depreciation. However, any amounts which may have been allowed as a deduction for depreciation under the income-tax law can not be restored.

33. A farmer bought a piece of land December 1, 1913. He has put no new money in the business, but has spent all his income from the land for tile and ditching. The farm cost originally $4,000, and is now easily worth $10,000. In computing invested capital should the value as of January 1, 1914, be taken?

No. The property will be valued at cost, less depreciation (on buildings, etc.), plus the amount of earnings from year to year invested in the permanent improvement of the property.

34. Article 18 of the regulations says that when the deduction is determined under article 24 a "constructive" capital will be used for applying the rates of taxation. It may be that in some cases it will be impossible to determine

satisfactorily the invested capital for the prewar period, but quite possible to determine the invested capital for the taxable year. In such cases the deduction will be determined under article 24. Will the constructive capital described in article 18 be used?

No. The constructive capital is to be used only in cases where it is impossible to determine satisfactorily the invested capital for the taxable year.

35. In 1900 a corporation was organized and took over a mining property then valued at $1,000,000. For this property the corporation issued stock to the amount of $1,000,000. As a result of development, the discovery of new ore bodies, etc., the property increased in value until in 1910 after an appraisal it was entered on the books at $10,000,000 and the surplus was increased accordingly. In 1917 another appraisal was had and the value of the property was then fixed at $15,000,000. The balance sheet of the corporation now shows capital stock of $1,000,000 and a surplus of $20,000,000, of which $14,000,000 is represented by the appreciation in value above described. May the appraised value of the property be taken as the basis for computing invested capital?

No. The excess-profits tax law expressly places the computation of invested capital upon the basis of the cash and other property actually put into the business, plus the earned surplus and undivided profits, and not upon that of a present valuation or appraisal of its assets. Returns in which the invested capital includes surplus or undivided profits computed upon present values as determined by an appraisal can not be accepted.

36. In 1907 a corporation acquired a manufacturing plant valued at $500,000, issuing therefor $500,000 of capital stock. The books of the corporation on December 31, 1916, showed a surplus of $1,000,000, accumulated through the earnings of the business. Most of this surplus was invested in increased plant equipment, etc. In December, 1917, the property was appraised (as of Jan. 1, 1917) by an appraisal company and the value fixed at $2,500,000, or $1,000,000 more than the values previously shown on the books. This increase was attributable mainly to increased value of land and in part to larger values placed by the appraisal company upon the machinery and equipment. May this appreciation of $1,000,000 be regarded as an earned surplus and the value fixed by the appraisal company in December, 1917, be taken as a basis for computing invested capital for that year?

No. The same rule applies here as in the case stated in question No. 35. For the purposes of the excess profits tax law appreciation in the value of property will not be regarded as earned surplus, and an appraisal of property upon current values will not be accepted as a basis for computing invested capital.

37. A proprietary medicine company has spent large sums in advertising and has thereby built up a good will. May these sums be included as expenditures for a capital asset?

If the money was spent from original capital the original capital is of course allowed. But if these advertising bills were paid from income and the amounts charged to general expense they can not be included as capital. Good will can be included only when bought and paid for specifically as such.

RETURNS.

38. A corporation is engaged in the brokerage business, employing only a nominal capital. According to article 73 of the regulations, it is taxable at the 8 per cent rate under section 209 of the law. Its income tax return is made out on Form 1031. Must it also make out a return on Form 1103, which apparently relates only to corporations having an invested capital?

Yes. Every corporation claiming to have only a nominal capital must file a return on Form 1103, however small its capitalization may be.

39. If a corporation claiming to have only a nominal capital files a return on Form 1103, will this not be construed as an admission that it has invested capital and is taxable at the graduated rates under section 201?

No. This return is required for the sake of information, so as to enable the department to determine the justice of the claim. The two forms (1031 and 1103) should be filed together and should be accompanied by a statement describing the nature of the business, the purposes for which the capital is employed, and any other facts tending to show that the corporation is of a kind properly taxable under section 209, at the 8 per cent rate.

40. In the case of a corporation claiming to have only a nominal capital, on which form and under what schedule should the tax at the 8 per cent rate be computed?

(*a*) In the case of a domestic corporation, take the net income as shown in item 6, Schedule I of Form 1103, compute 8 per cent on the amount thereof in excess of $3,000, and enter the result as item 12 on Form 1031. (*b*) In the case of a foreign corporation, if the net income shown in item 6, Schedule I of Form 1103 is in excess of $3,000 the tax will be 8 per cent upon the whole amount and should be entered as item 12 on Form 1031. (*c*) In either case it should be noted under item 12 that the tax is computed at the 8 per cent rate.

41. If a corporation during 1917 made less than 7 per cent on its invested capital, is it required to file an excess-profits return?

Every corporation having an income for the taxable year of $3,000 or over is required to file an excess-profits return, even though its total deduction may be in excess of its net income.

42. On Form 1065 (partnership-income return) it is stated on page 1, under "5. Excess Profits Tax," that "If the partnership reports any income from sources other than those included under A, page 3, it must make a return and compute the amount of tax (if any) on Form 1102." If a domestic partnership rendering professional or personal services and

reporting its main income in block A also reports a small amount of interest from bank balances, etc., in block F, will it be required to make a return on Form 1102?

No. The income of a partnership or corporation (unlike that of an individual) must be taxed as a unit—all under the graduated rates or all at 8 per cent. (See art. 14 of Regulations No. 41.) If the partnership has a substantial amount of capital (however invested), return must be made on Form 1102 for purposes of information. (See answers 38 and 39 above.) But if the partnership has only a small capital and is clearly taxable at the 8 per cent rate as to the income from its principal trade or business, any income which it derives from other sources will be taxed in the same manner and there will be no occasion for a return of invested capital.

43. In the case stated in question No. 42, how should the tax be computed?

In every case the excess-profits tax of a partnership is to be computed upon the net income, as shown in block G, page 4, of Form 1065. In the case above stated this will consist of the sum of the totals reported under A and F. The tax will be 8 per cent upon the amount by which this sum exceeds $6,000. (The statement on page 4 of Form 1065 that the excess-profits tax on a business with no invested capital, or only a nominal capital, will be "8 per cent of the amount by which the net total reported under A, page 3, exceeds $6,000, or in the case of a foreign partnership, 8 per cent of the entire net total reported under A" applies only in cases where the entire net income falls in block A.)

44. Will every partnership reporting income from business under block B, page 3 of Form 1065, be taxable at the graduated rates under section 201?

Not necessarily. Every partnership reporting income under block B must make a return on Form 1102. But if it is clear that its *principal* trade or business consists in rendering personal service (income reported under block A) and is taxable at the 8 per cent rate, all of its income will be taxed at that rate even though a part of it may be derived from "invested capital."

45. Block C, on page 3 of Form 1065, provides space for entering profits from sale of real estate, stocks, bonds, and other property. If a partnership sustains a net loss from such transactions can it take account of such loss in computing its net income subject to the excess-profits tax?

Yes. The loss should be entered in red ink or as a negative quantity in block C.

46. On the individual excess-profits tax return (Form 1101) there appears under schedule B a column for entering the "Cost" of assets acquired except "tangible property put into the business." Where should the value of tangible property put into the business be entered?

In the same column (column 2, headed "Cost"). If the property was put in before January 1, 1914, enter the value as of that date; if put in on or after that date, enter the value as of the time when put in. In all such cases enter along with the description of the asset the date when it was paid in.

47. If an individual who keeps books reports his invested capital in schedule A on Form 1101, must he also fill out schedule B?

Not necessarily. If invested capital is reported in schedule A, the return should be accompanied by a statement explaining adjustments. In many cases, however, it may be advisable to fill in the spaces provided in schedule B for the description of assets and their proper valuation. This may be useful in connection with the explanatory statement.

48. Item 7 in schedule A of Form 1101 (individual excess-profits tax return) calls for the excess of inadmissible assets over liabilities. Should an individual reporting his invested capital in schedule A specify the amount of liabilities and inadmissible assets respectively under items 23 to 27 of schedule B?

Yes. This is the most convenient way of explaining item 7 of schedule A.

49. How does a member of a partnership, in making his individual income-tax return, report his credit for his proportionate share of the excess-profits tax assessed against the partnership? Does he add that share to any excess-profits tax assessed against him as an individual and report this sum in block L on Form 1040?

No. On Form 1065, page 4, the partnership takes credit for its excess-profits tax (block J) before arriving at the net income to be shared by the partners (block K). So the individual partner in reporting his total net income (Form 1040, block K) has already deducted his proportionate share of the partnership excess-profits tax and he may not again include that share as a part of his deduction under block L of Form 1040. He should enter in that space only the amount of excess-profits tax, if any, assessed against his as an individual.

50. On page 2 of Form 1065 (partnership-income return), under the heading "Other expenses" is the following instruction: "Do not deduct salary for any partner's services unless such salary is paid in accordance with a prior agreement properly recorded on the books of the partnership." Does this instruction supersede article 32 of the regulations?

No. With respect to any period prior to March 1, 1918, a salary deduction for services actually rendered will be allowed regardless of whether a previous agreement had been made.

51. A corporation in which most of the stock is owned by its officers has in the past voted to its officers only nominal salaries as drawing accounts. In computing net income for purposes of the excess-profits tax may the corporation deduct as items of expense amounts which would constitute reasonable compensation for the services actually rendered by its officers?

Yes, if a satisfactory explanation is given. For any period prior to March 1, 1918, reasonable salaries for services actually rendered may be deducted, even though the full amounts had not been formally voted as salaries by the corporation.

○